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*This is the group
I talked to*

PARIS FOR USOECD; BEIJING PASS SHENYANG

E.O. 12356: N/A

TAGS: ECON, CH

SUBJECT: AMERICAN ECONOMISTS IMPRESSED BY CHINESE
REFORMS

1. SUMMARY: A TEAM OF AMERICAN ECONOMISTS WHO RECENTLY SPENT TWO WEEKS IN CHINA STUDYING INDUSTRIAL REFORM WAS STRUCK BY THE DYNAMISM OF THE REFORM PROGRAM AND BY THE DRAMATIC CONTRASTS BETWEEN THE CHINESE ECONOMY AND THOSE OF OTHER SOCIALIST STATES. ALTHOUGH IN SOME WAYS NOT AS RADICAL AS REFORM IN HUNGARY, FOR EXAMPLE, THE TEAM FOUND CHINA'S REFORM PROGRAM IMPRESSIVE FOR ITS PRAGMATIC, NON-IDEOLOGICAL APPROACH -- A CLEAR CONTRAST WITH THE "IMMOBILE" SOVIET SITUATION -- AND FOR ITS EMPHASIS ON REDUCING THE SCOPE AND ROLE OF PLANNING. ONE TEAM MEMBER OBSERVED THAT CHINA PRESENTS THE FIRST INSTANCE OF DECOLLECTIVIZATION OF AGRICULTURE IN THE COMMUNIST WORLD. THE TEAM SUMMED UP THE STRATEGY UNDERLYING CHINA'S REFORM EFFORT AS "OUTGROWING THE PLAN," AND IN FACT THEY FOUND THAT A STRIKING AMOUNT OF ECONOMIC ACTIVITY ALREADY TAKES PLACE OUTSIDE OF THE PLAN. ON THE OTHER HAND, PROGRESS IN RESTRUCTURING RELATIONSHIPS BETWEEN ENTERPRISES AND PLANNERS WITHIN THE PLANNED ECONOMY, THE FOCUS OF REFORM IN OTHER SOCIALIST COUNTRIES, HAS BEEN MODEST IN CHINA.

2. THE TEAM FOUND WIDELY DIFFERING PERCEPTIONS AMONG CHINESE OFFICIALS AND MANAGERS OF WHAT REFORM MEANS.

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WHILE CENTRAL PLANNERS ARE LOOSENING THEIR GRIP ON ECONOMIC ACTIVITY, MUNICIPAL OFFICIALS RETAIN A STRONG SENSE OF CONTROL, AND THE TEAM THOUGHT THAT THERE IS PROBABLY A RELATIONSHIP BETWEEN THE DIMINUTION OF CENTRAL CONTROL AND THE INCREASE OF LOCAL "GUIDANCE." CHINESE OFFICIALS ALSO DISPLAYED A WIDELY VARYING UNDERSTANDING OF WHAT CONSTITUTES "GUIDANCE." IN GENERAL, THE TEAM FOUND LESS CHANGE WITHIN THE PLANNING SYSTEM THAN OUTSIDE THAT SYSTEM. MOREOVER, THE TEAM BELIEVES THAT DIRECT ADMINISTRATIVE INTERFERENCE BY PLANNERS IS UNLIKELY TO DECREASE SOON, AS OFFICIALS ARE FORCED TO MAKE DIFFICULT DECISIONS ABOUT CORRUPTION, INEFFICIENCY, PRICES, AND THE NEED TO SATISFY VARIOUS INTERESTS THREATENED BY REFORM. TEAM MEMBERS DETECTED NO TIMETABLE FOR PRICE REFORM. ONE TEAM MEMBER CONCLUDED THAT UNLESS THE PACE OF REFORM WITHIN THE PLANNED SECTOR IS ACCELERATED, PLANNERS WILL BEGIN TO RESTRICT THE INFLUENCE OF MARKET FORCES ON ALLOCATION OF RESOURCES. END SUMMARY.

3. A STUDY TEAM OF AMERICAN ECONOMISTS, SPONSORED BY THE NATIONAL COMMITTEE ON US-CHINA RELATIONS, VISITED CHINA NOVEMBER 29-DECEMBER 15, 1984, TO INVESTIGATE AND REPORT ON INDUSTRIAL REFORM. THE TEAM LEADER WAS ABRAM BERGSON, EMERITUS PROFESSOR OF ECONOMICS AT HARVARD, AND THE DEPUTY LEADER WAS PROFESSOR ROBERT F. DERNBERGER OF THE UNIVERSITY OF MICHIGAN. THE OTHER MEMBERS OF THE TEAM WERE:

ARTHUR J. ALEXANDER, ASSOCIATE HEAD, ECONOMICS DEPARTMENT, THE RAND CORPORATION;

JOHN P. HARDT, SENIOR SPECIALIST IN SOVIET ECONOMICS, CONGRESSIONAL RESEARCH SERVICE, LIBRARY OF CONGRESS;

ED A. HEWETT, SENIOR FELLOW, FOREIGN POLICY STUDIES PROGRAM, THE BROOKINGS INSTITUTION;

BARRY J. NAUGHTON, ASSISTANT PROFESSOR OF ECONOMICS, UNIVERSITY OF OREGON (WHO DISTRIBUTED A 40-PAGE PRELIMINARY REPORT); AND

SUSAN L. SHIRK, ASSOCIATE PROFESSOR OF POLITICAL SCIENCE, UNIVERSITY OF CALIFORNIA, SAN DIEGO.

4. THE TEAM PRESENTED ITS PRELIMINARY FINDINGS AT A MARCH 15 SEMINAR AT THE LIBRARY OF CONGRESS. THE TEAM'S

OBSERVATIONS WERE BASED ON DISCUSSIONS WITH ECONOMIC OFFICIALS AND ENTERPRISE MANAGERS DURING A TWO-WEEK TRIP TO BEIJING, DALIAN, CHONGQING, AND SHENZHEN. DR. SHIRK SPENT FOUR MONTHS OF STUDY IN BEIJING BEFORE JOINING THE TEAM. MOST OF THE TEAM MEMBERS ARE SPECIALISTS IN NON-MARKET ECONOMIES, AND THEIR PRIMARY GOAL WAS TO DEVELOP AS ACCURATE A PICTURE AS POSSIBLE OF THE CHANGES THE CHINESE ARE UNDERTAKING AND HOW THESE CHANGES ARE UNDERSTOOD BY CHINESE OFFICIALS AND MANAGERS. THE TEAM MEMBERS WERE VERY IMPRESSED WITH THE ACCESS WHICH THEY HAD TO CHINESE OFFICIALS, AND WITH THE OPENNESS OF DISCUSSIONS. A FULL REPORT WILL BE PUBLISHED IN SEPTEMBER, BUT HIGHLIGHTS OF THE TEAM'S FINDINGS ARE OUTLINED BELOW.

GENERAL OBSERVATIONS: DRAMATIC CHANGE

5. THE TEAM'S SOVIET AND EASTERN EUROPEAN SPECIALISTS (BERGSON AND HEWETT) WERE STRUCK BY THE DRAMATIC CONTRASTS BETWEEN CHINA AND OTHER COMMUNIST STATES. COMPARED TO THE "IMMOBILE" SOVIET SITUATION, AND EVEN WITH HUNGARY, BERGSON FOUND THE CHINESE PROGRAM ON A

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PLANE BY ITSELF. HEWETT, HOWEVER, THOUGHT THAT CHANGES IN CHINA WERE NOT YET AS RADICAL AS IN HUNGARY, WHERE PLAN-ORIGINATED DIRECTIONS TO ENTERPRISES WERE ABANDONED IN 1965. BERGSON DREW ATTENTION TO AGRICULTURE; IN THE COMMUNIST WORLD, COLLECTIVIZATION HAD FAILED TO TAKE HOLD ONLY IN POLAND AND YUGOSLAVIA. OF THOSE COMMUNIST STATES WHERE COLLECTIVIZATION WAS ADOPTED, ONLY CHINA HAS SINCE ABANDONED IT. THE TEAM BELIEVES SUCCESSES IN AGRICULTURE HAVE STRENGTHENED THE HAND OF CHINESE REFORMERS AND GIVEN REFORM A MOMENTUM OF ITS OWN.

6. THE TEAM WAS IMPRESSED BY THE WILLINGNESS OF THE CHINESE LEADERSHIP TO ABANDON THE USUAL SOVIET-STYLE RESPONSES TO ECONOMIC PROBLEMS AND INSTEAD SEEK PRAGMATIC SOLUTIONS, AN ATTITUDE WHICH OPENS THE DOOR TO A UNIVERSE OF POSSIBLE APPROACHES. THE TEAM FOUND LITTLE CONCERN AMONG CHINESE OFFICIALS ABOUT THE IDEOLOGICAL CONTRADICTIONS OF REFORM, SUCH AS GROWING INCOME DISPARITIES AND THE POTENTIAL DEVELOPMENT OF A RENTIER CLASS. DR. SHIRK COMMENTED THAT MOST CHINESE OFFICIALS TALK ABOUT "ZHAO ZIYANG'S REFORM PROGRAM," AND ATTRIBUTE THE KEY DECISIONS TO ZHAO AND THE FINANCE AND ECONOMIC SMALL GROUP OF THE STATE COUNCIL. THE EXCEPTION IS AGRICULTURAL REFORM, WHERE HU YAOBANG AND THE PARTY PLAY AN IMPORTANT ROLE. DENG XIAOPING IS NOT THOUGHT TO BE INVOLVED IN OPERATIONAL DECISIONMAKING ON REFORMS.

REFORM STRATEGY: "LET THE ECONOMY OUTGROW THE PLAN"

7. REFORMERS HAVE NO PRECISE PLAN FOR THE FUTURE; THEY TRY SOMETHING, THEN DECIDE ON THE NEXT STEP AFTER ASSESSING THE RESULTS. JUST AS THE CHINESE ECONOMY HAS BEEN LESS EFFECTIVELY PLANNED THAN OTHER SOCIALIST ECONOMIES, SO ITS REFORM PROCESS IS ALSO LESS PLANNED, AND LESS EFFECTIVELY CONTROLLED. THE UNDERLYING STRATEGY OF CHINA'S REFORM, NOT NECESSARILY ARTICULATED BY THE REFORMERS, IS TO CREATE CONDITIONS WHICH WILL ALLOW THE ECONOMY TO OUTGROW CENTRAL PLANNING. IN FACT, THE TEAM OBSERVED THAT A STRIKING AMOUNT OF ECONOMIC ACTIVITY IN CHINA ALREADY TAKES PLACE OUTSIDE THE PLAN.

8. AS REFORMS ARE INTRODUCED, THEY EXPAND AND LEGITIMIZE NON-PLAN ACTIVITY, AND THEY CREATE A REFORM COALITION WITH VESTED INTERESTS IN CONTINUING AND EXPANDING REFORMS. FOR EXAMPLE, MANY FIRMS NOW SEE EXTRA-PLAN SALES AT HIGHER, NON-PLAN PRICES AS A RIGHT; LOCAL OFFICIALS ARE BEING GIVEN GREATER CONTROL OVER RESOURCE ALLOCATION (ALTHOUGH IN THE LONG RUN THIS POSES AN OBSTACLE TO ENTERPRISE AUTONOMY); CENTRAL BUREAUCRATS RECOGNIZE THE STEADY EROSION OF CENTRAL CONTROL OVER THE ECONOMY, AND HAVE INITIATED SOME OF THE MOST SIGNIFICANT REFORMS AS A MEANS OF STABILIZING THE EROSION AND RETAINING SOME CONTROL OVER RESOURCE ALLOCATION. THE TEAM FOUND THE WILLINGNESS OF CHINESE CENTRAL PLANNERS TO TOLERATE EXTRA-PLAN ACTIVITY TO BE UNIQUE AMONG COMMUNIST COUNTRIES. HOWEVER, PROGRESS IN RESTRUCTURING RELATIONSHIPS BETWEEN ENTERPRISES AND PLANNERS WITHIN THE PLANNED ECONOMY, THE FOCUS OF REFORM IN OTHER SOCIALIST COUNTRIES, HAS BEEN MODEST.

9. THE REFORM COALITION HOLDS TOGETHER ON THE ASSUMPTION THAT NO ONE WILL BE WORSE OFF THAN BEFORE THE REFORMS, AND MANY WILL BENEFIT. REFORM IS INHERENTLY REDISTRIBUTIVE, HOWEVER, AND PRESERVING ORIGINAL POSITIONS DRAINS SCARCE RESOURCES AND CREATES A CONTRADICTION BETWEEN MAINTAINING SUBSIDIES AND INCREASING EFFICIENCY. BUT CLOSING INEFFICIENT ENTERPRISES CREATES ECONOMIC AND POLITICAL PROBLEMS THAT MAY BE UNACCEPTABLE. ONE POSSIBLE RESPONSE TO THIS

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PROBLEM IS TO CONFINE REFORM TO THE MARGIN; THAT IS, TO RETAIN EXISTING INEFFICIENT ENTERPRISES, BUT REQUIRE ALL FUTURE INVESTMENT PLANS TO REFLECT REFORM CRITERIA. THIS METHOD OF "GROWING INTO REFORM," WHILE POLITICALLY ATTRACTIVE, COULD SLOW THE PACE OF REFORM AND CONTAINS NO GUARANTEE OF SUCCESS.

PLANNING: CHINESE NOTIONS COVER A WIDE SPECTRUM

10. THE TEAM FOUND WIDELY DIFFERING PERCEPTIONS AMONG OFFICIALS AND MANAGERS OF WHAT REFORM MEANS. CENTRAL PLANNERS SAW THAT PORTION OF THE ECONOMY UNDER THEIR CONTROL SHRINKING AND TENDED TO EQUATE THIS WITH "REFORM." THEY WERE VAGUE ABOUT REFORM IMPLEMENTATION AT THE LOCAL LEVEL, AND VIEWED LOCAL-LEVEL PLANNING AS "GUIDANCE PLANNING." OFFICIALS AND MANAGERS IN DALIAN, HOWEVER, TENDED TO VIEW GUIDANCE PLANNING SIMPLY AS TRADITIONAL CENTRAL PLANNING CARRIED OUT AT THE LOCAL LEVEL, AND HAD THE QUITE ERRONEOUS IDEA THAT "REFORM" MEANS ACCELERATION OF THE GROWTH RATE OF OUTPUT. DALIAN OFFICIALS ARGUED THAT IF A LOCALITY COULD GUARANTEE INPUTS TO A FACTORY, IT HAD THE RIGHT TO ISSUE COMPULSORY PLANS. IN FACT, DALIAN OFFICIALS HAD A SKEWED VERSION OF ANOTHER REFORM CONCEPT: THEY CONSIDERED ALLOCATION OF SCARCE RESOURCES AT LOW STATE-SET PRICES TO BE AN EXAMPLE OF USING "ECONOMIC LEVERS" TO GUIDE THE ECONOMY.

11. DALIAN OFFICIALS DIFFERENTIATED BETWEEN COMPULSORY PLANS, WHERE THE STATE PROVIDES ALL MAJOR INPUTS, AND GUIDANCE PLANS, WHERE THE STATE PROVIDES ONLY KEY ENERGY AND MATERIAL INPUTS AND THE ENTERPRISE MUST OBTAIN THE REMAINDER OF WHAT IT NEEDS AT HIGHER PRICES ON THE "MARKET." THIS IMPLIES LITTLE PRACTICAL DIFFERENCE BETWEEN COMPULSORY AND GUIDANCE PLANNING, SINCE EITHER WAY THE ENTERPRISE MUST CONFORM TO A PLAN IF IT IS TO OBTAIN ESSENTIAL INPUTS. HOWEVER, CONTRARY VIEWS IN CHONGQING AND SHENZHEN, WHERE OFFICIALS AND MANAGERS WERE MORE MINDFUL OF THE IMPORTANCE OF ALLOWING MARKET FORCES TO OPERATE, SUGGESTS THAT THERE IS SUBSTANTIAL REGIONAL VARIATION IN THE WAY GUIDANCE PLANS ARE IMPLEMENTED. MOREOVER, DALIAN OFFICIALS CONFIRMED THAT ENTERPRISES CAN REFUSE TO ACCEPT PLANS IF THEY CAN OBTAIN THE INPUTS THEY NEED ON THE NON-PLAN ECONOMY, WHICH MAY BE INCREASINGLY IMPORTANT AS THE NON-PLAN ECONOMY EXPANDS. WHAT CHINESE PLANNERS CALL "REFORM" SHOULD PERHAPS BE DESCRIBED AS ATTEMPTS TO INTRODUCE A WIDER RANGE OF VARIABLES INTO THE BARGAINING RELATIONSHIP BETWEEN ENTERPRISES AND THEIR SUPERIORS.

12. IN SUM, THE TEAM THOUGHT THAT THERE CONTINUED TO BE A STRONG SENSE OF CONTROL AT MUNICIPAL LEVELS, AND THOUGHT THERE IS PROBABLY A RELATIONSHIP BETWEEN THE DIMINUTION OF CENTRAL CONTROL AND THE INCREASE OF LOCAL "GUIDANCE." BUT LOOKING AT THE ENTIRE ECONOMY, THEY FOUND LESS CHANGE WITHIN THE PLANNING SYSTEM THAN OUTSIDE THAT SYSTEM.

PROBLEMS: PRICES, LEGACIES, CORRUPTION

13. PRICES: THE TEAM'S VIEW THAT PRICES IN CHINA DO NOT ACCURATELY REFLECT SCARCITY VALUES AND THE DICTATES OF SUPPLY AND DEMAND SURPRISINGLY PROVOKED SOME DEBATE BY TWO IN THE SEMINAR AUDIENCE. WHILE CONCEDING THAT KEY PRICES, INCLUDING THOSE FOR ENERGY AND CAPITAL, ARE IRRATIONAL, THEY ARGUED THAT AVERAGE PRICES FOR MANY INTERMEDIATE GOODS ARE CLOSE TO WORLD PRICES. TEAM MEMBERS POINTED OUT, HOWEVER, THAT WHAT IS IMPORTANT IS NOT AVERAGE PRICES BUT RELATIVE PRICES, AND IN ANY EVENT HOW CAN DOMESTIC PRICES BE COMPARED WITH WORLD PRICES IN

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THE ABSENCE OF AN EXCHANGE RATE WHICH REFLECTS THE RELATIVE SCARCITY OF FOREIGN EXCHANGE? MOREOVER, TEAM LEADER BERGSON SAID HE WOULD BE "ASTONISHED" IF PRICES SET BY THE GOVERNMENT DECADES AGO AND ADJUSTED VERY LITTLE SINCE BEAR ANY RELATION TO ACTUAL SCARCITY. DR. NAUGHTON IDENTIFIED CHINA'S DUAL, OR MULTIPLE, PRICE SYSTEM, IN WHICH A GROWING PROPORTION OF TRANSACTIONS TAKE PLACE OUTSIDE THE PLAN, AS ONE OF THE KEY FEATURES OF ECONOMIC LIFE. HE AND OTHER TEAM MEMBERS DID NOT DETECT, HOWEVER, A TIMETABLE FOR FORMAL PRICE REFORM.

14. LEGACIES: DR. HEWETT REFERRED TO THE PROBLEM OF WHAT HE CALLED LEGACIES -- THOSE ASPECTS OF ECONOMIC HISTORY WHICH CANNOT SIMPLY BE WIPE FROM THE SLATE. THIS COULD BE EXPECTED TO LEAD TO ENDLESS BATTLES FOR EXCEPTIONS FROM REFORM MEASURES AND FOR SUBSIDIES. ANOTHER PROBLEM IS A SOCIALIST SYSTEM'S OBLIGATIONS TO WORKERS; HOW TO ECONOMIZE ON LABOR? HOW, IN SHORT, CAN REFORM BE CARRIED OUT WITHOUT PENALTIES TO SOME, WHICH THE CHINESE HAVE AT LEAST CLAIMED THEY WILL AVOID?

15. CORRUPTION AND COMPETING GOALS: THE TEAM NOTED THAT THE REFORM EFFORT HAS CREATED FUNDAMENTAL TENSIONS BETWEEN COMPETING GOALS AND INTERESTS. TENSIONS WHICH ARE COMPLICATED BY THE HAZINESS OF REFORM STRATEGY AND BY THE INEVITABLE RISE OF ENTREPRENEURS, OPPORTUNISTS, AND OTHER VESTED INTERESTS WHOSE PURSUIT OF THEIR OWN OBJECTIVES MAY INFLUENCE THE DIRECTION OF REFORM IN WAYS UNFORSEEN BY THE LEADERSHIP. FOR EXAMPLE, REFORM AND THE DUAL ECONOMIC SYSTEM IT HAS CREATED GENERATE NEW OPPORTUNITIES FOR CORRUPTION, A SITUATION COMPLICATED BY THE LACK OF CLEAR STANDARDS FOR WHAT IS AND IS NOT LEGITIMATE ACTIVITY. MOREOVER, IT IS NOT CLEAR HOW CORRUPTION IS TO BE AVOIDED GIVEN THE EXISTENCE OF SCARCITIES, DUAL ECONOMIES, AND MULTIPLE PRICE SYSTEMS.

16. OTHER TENSIONS ARE LIKELY TO ARISE FROM THE TENDENCY TO EQUATE REFORM WITH ACCELERATED GROWTH OF OUTPUT, WHICH COULD LEAD TO INCREASING DISRUPTION OF ALREADY-SCARCE ENERGY SUPPLIES, AND FROM THE SHORTAGES AND INFLATION LIKELY TO DEVELOP IN THE WAKE OF WEAKENING CONTROL OVER BONUSES AND WAGES. AT LEAST PARTIALLY AS A RESULT, DIRECT ADMINISTRATIVE INTERFERENCE BY PLANNERS IS UNLIKELY TO DECREASE, AND EXISTING PROBLEMS IN NEED OF REFORM, SUCH AS UNCONTROLLED INVESTMENT, ARE LIKELY TO CONTINUE. TO QUOTE DR. NAUGHTON'S CONCLUDING LINES IN HIS PRELIMINARY REPORT, "CHINA'S REFORMS ARE THUS BOTH MORE AND LESS THAN MEETS THE EYE. IN THE YEARS TO COME, THE PACE OF REFORM WITHIN THE STATE SECTOR WILL HAVE TO BE ACCELERATED, OR ELSE PLANNERS WILL INEVITABLY BEGIN TO REVERSE DIRECTION AND RESTRICT THE INFLUENCE OF SEMI-CONTROLLED MARKET FORCES ON THEIR ALLOCATION OF RESOURCES. IT IS, HOWEVER, JUST THIS COMMITMENT TO THE ACCELERATION OF REFORM WHICH WAS THE MOST CHARACTERISTIC PART OF THE POLITICAL ENVIRONMENT SO PROMINENT IN BEIJING." ARMACOST

END OF MESSAGE

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